1/23/86 B5350-2A

The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

FRIDAY, JANUARY 17, 1986 VOLUME XXIII, NUMBER 3

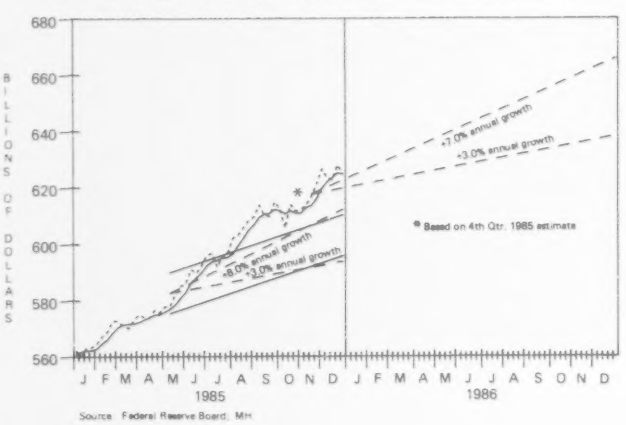
Great Expectations . . .

The likelihood of some upbeat economic statistics in coming weeks has prompted a decided reversal of fortunes in the credit markets—sending bond prices lower and yields somewhat higher. To a large extent, this development reflected the growing belief among market participants that if the economy is brightening, then prospects for a further easing of monetary policy are dimming, if not disappearing altogether. However, Fed policy actions have failed to live up to the most bullish of market expectations for quite some time (Financial Digest—December 2, 1985), not surprising when you consider the still sizable overrun in M1 money supply growth and concerns that too rapid a dollar decline in the foreign exchange markets could touch off another round of accelerating inflation rates. Since these concerns have not abated to any great extent, monetary policy initiatives will probably remain on hold for the time being, with the central bank encouraging neither higher nor lower interest rates.

Perhaps the most important factor behind the abrupt shift in market sentiment has been the course of recent business developments. With payroll employment expanding by a hefty 320,000 in December—or some 25 percent better than the preceding five-month average—and the unemployment rate sinking below seven percent, the ingredients for a bond market retreat began to fall into place. Since these numbers tend to act as leading indicators of trends in industrial production, capacity utilization and personal incomes growth, good-sized employment gains would suggest not only good-sized gains in these other business statistics, but also would enhance the likelihood that the 3.2 percent, fourth quarter "flash" estimate of gross national product growth was on the low side. Thus, with the economy seemingly emerging from its recent doldrums, and even the hard-pressed manufacturing sector enjoying some modest employment and production gains, the need for more monetary stimulation, at this time at least, would appear to have diminished.

Such trends do not, however, preclude ease forever, or suggest any near-term moves toward restraint—however modest. For one thing, some of the glow associated with December's statistics could fade. Nagging doubts persist regarding the sustainability of today's robust consumer spending levels; the solid retail sales gain posted last month, for instance, could be reversed if either consumer confidence ebbs or households aggressively initiate steps to rebuild depleted savings balances.

MONEY SUPPLY, M1
FOUR WEEK MOVING AVERAGE (LINE) VS. WEEKLY FIGURES (DOT)



Source: Federal Reserve Board; MH

. . . Of More Monetary Ease . . .

What is more, the outlook for business capital spending remains clouded, if for no other reason that the fact that capacity utilization rates nationwide still stand nearly six full percentage points below those usually prevailing at this stage of the business cycle. Add to this the ongoing challenge of global competition to domestic industry and the uncertainty associated with proposed tax reform legislation, and it appears likely that capital spending will be lackluster this year—as recent surveys suggest. In fact, while GNP growth could perk up this year, it will be due mostly to stepped-up business inventory spending and a bottoming out of the trade deficit, not to a sustained upturn in final demand—two slim pillars on which to rest the fourth year of today's business expansion. But for now, the emergence of stronger economic statistics has given pause to further easing initiatives.

Money supply and Federal budget developments as well point toward a steady monetary policy course.

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As the new year unfolds, the Fed finds itself with an M1 money number standing some $12½ billion above 1985's upper growth target—not to mention slightly above 1986's seven percent upper growth target. Although M1 can expand by about $3 billion monthly and still end the year within target, since this year's growth will be starting from a large $5 billion average monthly increase in 1985, the Fed will undoubtedly be very wary of allowing once again large overshoots of its money growth targets. Even the growth of the broader money measures, M2 and M3, while within target, has picked up recently, a negative development which suggests a degree of caution on the part of the policymakers before taking steps which could stimulate additional money growth.

Other concerns abound as well. The government's estimate that the fiscal 1986 Federal budget deficit could hit a record $220 billion, together with legal challenges to the constitutionality of the Gramm-Rudman budget balancing bill, have heightened investor worries that the momentum toward putting in place a credible deficit reduction program could be slipping away. This would suggest that Washington's financial profligacy, and borrowing requirements, are not going to recede anytime soon, keeping the heat on the debt markets. For the monetary authorities, it implies that the need to loosen, if fiscal policy is tightened, has faded as well.

. . . Appear Dashed For Now

While business trends, money supply developments

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 1/15/86	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	188.911	+ 1.033	+40.281
Loans to Depository Inst.	.615	+ .003	– .585
Float	.581	– .545	– .083
Total Reserve Bank Credit	205.173	+ .545	+21.421
Treasury Deposits with Federal Reserve Banks	5.032	+ .892	+ 1.569
Currency in Circulation	194.049	– 2.266	+13.457
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	125.691	– .821	+ 7.509
	1/15/86		
Member Bank Reserves:			
Total Reserves Held	48.336	+ 1.091	+ 6.910
Excess (Deficiency)	1.252	– .078	+ .618
Net Free Reserves	1.109	+ .645	+ .442
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (1/6/86)	628.5	+ 9.0‡	+ 11.6‡
M2 (December '85)	2,563.1	+ 5.4	+ 8.1
M3 (December '85)	3,213.5	+ 5.6	+ 7.3
Domestic Nonfinancial Debt (3rd Q'85)	6,523.1	+ 11.7	+ 13.7

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 1/17/86	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.07%	7.18%	7.23%
* Federal Agencies	7.38	7.40	7.38
* Municipal Notes—High Grade (46% Taxable Equivalent)	10.19	9.63	10.19
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.82	7.82	7.87

‡ Finance Company Paper—Prime

5- 14 days	7.65%
15- 29 days	7.75
30- 59 days	7.80
60- 89 days	7.75
90-179 days	7.70
180-239 days	7.65
240-270 days	7.65

‡* Bankers' Acceptances

Feb.	7.70%
Mar.	7.70
Apr.	7.65
May	7.65
Jun.	7.65
Jul.	7.60

‡ Industrial Paper—Prime

30- 89 days	7.73%
90-120 days	7.60

†Federal Funds Effective Rate 7.85%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'85	$ 4,017	$ 3,961	$ 3,812
Gross National Product (1982 Dollars)*	3rd Q'85	$ 3,584	$ 3,557	$ 3,510
Percent Change, Annual Rate	3rd Q'85	3.0	1.1	2.1
Change in Consumer Prices*	Nov '85	7.2%	3.6%	2.4%
Change in Producer Prices*	Dec '85	4.8%	9.6%	0.0%
Civilian Employment (Thousands of Persons) †	Dec '85	108,206	107,969	106,248
Unemployment as % of Civilian Labor Force†	Dec '85	6.9%	7.0%	7.2%
Personal Income*	Nov '85	$ 3,345	$ 3,326	$ 3,184
Leading Indicators Composite Index (1967=100)†	Nov '85	171.5	171.3	165.1
Industrial Production Index (1977=100) †	Dec '85n	126.0	125.1	123.3
Net Change in Consumer Installment Credit †	Nov '85n	$ 4.88	$ 8.13r	$ 6.08
U.S. Merchandise Trade Balance †	Nov '85	–$ 13.68	–$ 11.45	–$ 10.22
Plant and Equipment Expenditures*	1st Q'86	$402.13(a)	$388.98(a)	$371.16
Private Housing Starts (Thousands of Units)*	Dec '85n	1,840	1,566r	1,630
New Construction Expenditures*	Nov '85	$ 348.2	$ 346.3	$ 313.1
Total Business Inventories †	Nov '85n	$ 583.4	$ 582.2r	$ 571.2
Total Business Sales †	Nov '85n	$ 432.3	$ 426.0r	$ 417.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

and the persistence of 12-digit Federal budget deficits all indicate a steady monetary posture, foreign exchange market developments probably do too—at least for now. The Group of Five major industrial nations (G-5) has so far been successful in dampening the dollar's external value, but they may not want this process to be carried too far, too fast. For one thing, if a cut in the discount rate, for example, accelerated the dollar's descent, it could have disturbing implications for our inflation rate. For another, the overseas participants in G-5 undoubtedly have their own reasons for fearing such a development, since it would tend to enhance U.S. global competitiveness at their exporters' expense. Thus, any policy loosening would probably be undertaken only in close cooperation with our overseas partners.

But there may be another good reason why the Fed may wish to postpone another round of ease. This is because if the pace of business picks up decidedly here while inflation rates are low and growth overseas remains lackluster, the dollar may well begin to strengthen again in the foreign exchange markets. Rather than move toward restraint, monetary policy may have to be eased, in order to forestall another sustained ascent of the dollar. If so, the Fed may well need just such ammunition as a discount rate cut later this year. H

The next issue will be dated February 3.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (1/1/86)	164,139	+ 4,367	+ 3,428
New York City (1/8/86)	37,289	– 57	+ 2,281
Commercial Paper (1/8/86)	296,252	+ 2,343	+60,259

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/1/86)	260,200	+ 4,955	+ 6,969
New York City (1/8/86)	59,649	+ 101	– 2,712

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/1/86)	726,566	+ 8,866	+ 61,590
New York City (1/8/86)	162,268	+ 4,894	+ 18,370

Financial Markets

	Friday 1/17/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.33%	– .09	– .62
180-Day Bills†	7.58	– .10	– .77
Longest Bills†	7.75	– .07	– 1.20
Recent Issues:			
7 7/8s 12/31/87	8.17	– .09	
8 3/8s 12/31/89	8.59	– .10	
9 1/2s 11/15/95	9.22	– .08	
9 7/8s 11/15/15	9.40	– .07	
Municipals:			
Bond Buyer–20 Bond Index* (1/16/86)	8.10%	+ .06	– 1.41
Blue List Total ($ Million)	$1,438	+ $ 59	+ $184
30-Day Visible Supply ($ Million)	$ 945	+ $336	+ $514
Total	$2,383	+ $395	+ $698
Corporates:			
Moody's Aa Composite (1/16/86)	10.57%	+ .19	+ 1.06
30-Day Visible Supply ($ Million)	$1,310	+ $125	+ $790
Stocks:			
Dow-Jones Averages:			
Industrials	1,536.70	+ 23.17	+ 309.34
Transportation	716.64	+ 29.67	+ 138.92
Utilities	172.75	–0–	+ 25.21
65 Stocks	615.02	+ 12.19	+ 117.87
N.Y.S.E. Composite Index	120.33	+ 1.51	+ 21.29
N.Y.S.E. Avg. Daily Vol. for Week (000's)	149,610	+ 3,008	+ 22,734

* 46% Taxable equivalent 15.00%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 1/17/86	Week Ago
Overnight	7.75%	7.75%
1 month	8.06	8.19
3 month	8.06	8.19
6 month	8.06	8.25
1 year	8.25	8.44
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	9.25%	9.20%
Long Term (7 to 15 yrs.)	9.80	9.70

FOREIGN EXCHANGE SPOT RATES

New York Opening (1/17/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01987	50.3300
Canada	.7135	1.4015
Denmark	.1107	9.0345
France	.1322	7.5650
Germany	.4057	2.4650
Italy	.0005951	1680.50
Japan	.004938	202.50
Mexico	.002205	453.50
Netherlands	.3601	2.7770
Switzerland	.4789	2.0880
U.K.	1.4360	.6964

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